

MANAGEMENT'S DISCUSSION AND ANALYSIS
AND BASIC FINANCIAL STATEMENTS

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)
Years ended September 30, 2004 and 2003

Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

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Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Management's Discussion and Analysis and Basic Financial Statements

Years ended September 30, 2004 and 2003

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Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center)

Management's Discussion and Analysis

This section of the Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center) (the "Hospital"), annual financial report provides important background information and management's analysis of the Hospital's financial performance during the fiscal year ended September 30, 2004. Please read this section in conjunction with the basic financial statements in this report.

Required Financial Statements

The basic financial statements contained in this report are presented using Governmental Accounting Standards Board ("GASB") accounting principles. These financial statements offer short-term and long-term financial information about the Hospital's activities.

The balance sheets include all of the Hospital's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). They also provide the basis for computing rate of return, evaluating the capital structure of the Hospital, and assessing the liquidity and financial flexibility of the Hospital.

All of the current year's revenues and expenses are accounted for in the statements of revenues, expenses, and changes in net assets. This statement measures changes in the Hospital's operations over the past years and can be used to determine whether the Hospital has been able to recover all of its costs through its net patient service revenue and other revenue sources.

The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about the Hospital's cash from operating, investing, and financing activities, and to provide answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the Hospital

The balance sheets and the statements of revenues, expenses, and changes in net assets report information about the Hospital's activities. Increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors such as changes in the health care industry, changes in Medicare and Medicaid regulations, and changes in managed care contracting should also be considered.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
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Management's Discussion and Analysis (continued)

Financial Highlights

The following summarizes the Hospital's financial highlights for the year ended September 30, 2004.

The Hospital generated \$19,984,000 in cash from operations during the year ended September 30, 2004. Investments in property and equipment totaled \$18,681,000 for the 2004 fiscal year. Additionally, the Hospital repaid all of the outstanding long-term debt.

The Hospital reported an increase in net patient service revenue of \$2,016,000 in 2004. This was a 3% increase compared to 2003. The increase was driven by volume increases, a rate increase, and the introduction of new services in 2004.

The Hospital's operating margin was 13.0% in 2004 versus 14.2% in 2003. Operating expenses increased at a slightly faster rate than operating revenue.

Balance Sheets

The Hospital's condensed balance sheets are presented below:

TABLE 1

	September 30 2004	2003	Dollar Change	Percent Change
	<i>(In Thousands)</i>			
Total current assets	\$ 26,905	\$ 25,135	\$ 1,770	7%
Property, plant, and equipment – net	61,358	50,071	11,287	23%
Other assets, including assets whose use is limited	70,818	89,383	(18,565)	(21)%
Total assets	<u>\$ 159,081</u>	<u>\$ 164,589</u>	<u>\$ (5,508)</u>	<u>(3)%</u>
Total current liabilities	\$ 10,962	\$ 11,553	\$ (591)	(5)%
Long-term debt	–	16,233	(16,233)	(100)%
Total liabilities	<u>10,962</u>	<u>27,786</u>	<u>(16,824)</u>	<u>(61)%</u>
Net assets	148,119	136,803	11,316	8%
Total liabilities and net assets	<u>\$ 159,081</u>	<u>\$ 164,589</u>	<u>\$ (5,508)</u>	<u>(3)%</u>

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Management's Discussion and Analysis (continued)

As shown in Table 1, total assets decreased by \$5,508,000, or 3%, to \$159,081,000 at September 30, 2004, up from \$164,589,000 at September 30, 2003. The change in total assets results primarily from investments being sold to retire long-term debt.

Current Assets

Increases in current assets result primarily from the accumulation of cash and a reduction in accounts receivable of approximately \$0.7 million at September 30, 2004, compared to the amount at September 30, 2003. Management intends to continue investing excess cash in investments. At September 30, 2004, current assets continued to exceed current liabilities. The current ratio increased to 2.5 at September 30, 2004, versus 2.2 at September 30, 2003. While an increase in this ratio indicates a positive trend, these calculations exclude consideration of the investments designated by the board of commissioners for plant repair and expansion. Including these liquid investments in the calculations would yield substantially higher ratios.

Property, Plant, and Equipment

The following table presents the components of the Hospital's property, plant, and equipment at September 30, 2004 and 2003:

TABLE 2

	September 30	
	2004	2003
	<i>(In Thousands)</i>	
Land and land improvements	\$ 3,370	\$ 3,338
Building, fixed equipment, and equipment	93,218	90,454
Subtotal	96,588	93,792
Less accumulated depreciation and amortization	(49,621)	(46,339)
Construction in progress	14,391	2,618
Net property, plant, and equipment	<u>\$ 61,358</u>	<u>\$ 50,071</u>

During fiscal year 2004, the Hospital invested \$18,681,000 in a broad range of capital assets. Net property, plant, and equipment has increased as the Hospital has enhanced existing facilities and equipment, and is in the process of building new space to accommodate inpatient services. These additions exceeded the current fiscal year's depreciation expense.

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Management's Discussion and Analysis (continued)

In Table 3, the Hospital's fiscal year 2005 capital budget projects spending up to \$38,000,000. These projects will be financed from operations. More information about the Hospital's capital assets is presented in the notes to the basic financial statements.

TABLE 3

Equipment purchases	\$ 2,000,000
Construction/renovation	36,000,000
Total	<u>\$ 38,000,000</u>

Long-Term Debt

At year-end, the Hospital had no debt outstanding as it was repaid in full during the year. A premium of \$331,000 was paid as a result of this transaction. No new long-term debt was incurred in the current year.

Net Assets

The following table presents the components of the Hospital's net assets at September 30, 2004 and 2003:

TABLE 4

	September 30	
	2004	2003
	<i>(In Thousands)</i>	
Invested in capital assets, net of related debt	\$ 61,358	\$ 33,413
Restricted	—	2,570
Unrestricted	86,761	100,820
	<u>\$ 148,119</u>	<u>\$ 136,803</u>

During 2004, total net assets increased \$11,317,000, or 8%, as a result of revenue exceeding expenses.

The Hospital purchased \$18,681,000 of property, plant, and equipment during 2004, which increased the reported amount of net assets invested in capital assets, net of related debt, and made principal payments on related debt of \$16,950,000. This increase was offset by depreciation expense of \$7,273,000.

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Management's Discussion and Analysis (continued)

Statements of Revenue and Expenses

A summary of the Hospital's revenues and expenses for fiscal years 2004 and 2003 is presented below:

TABLE 5

	Year ended September 30 2004	2003	Dollar Change	Percent Change
	<i>(In Thousands)</i>			
Revenue:				
Net patient service revenue	\$ 78,648	\$ 76,632	\$ 2,016	3%
Other revenue	1,371	1,566	(195)	(12)%
Total revenue	<u>80,019</u>	<u>78,198</u>	<u>1,821</u>	<u>2%</u>
Expenses:				
Salaries and wages and employee benefits and payroll taxes	30,197	29,454	743	3%
Other operating expenses	30,965	30,524	441	1%
Depreciation and amortization	7,366	6,084	1,282	21%
Interest	278	1,037	(759)	(73)%
Total expenses	<u>68,806</u>	<u>67,099</u>	<u>1,707</u>	<u>3%</u>
Income from operations	11,213	11,099	114	(1)%
Nonoperating income	931	1,149	(218)	(19)%
Bond retirement costs	(828)	—	(828)	(100)%
Revenue in excess of expenses	<u>\$ 11,316</u>	<u>\$ 12,248</u>	<u>\$ (932)</u>	<u>(8)%</u>

Net Patient Service Revenue

During fiscal year 2004, the Hospital derived 98% of its total operating revenue from net patient service revenue. Total net patient service revenue increased \$2,016,000, or 3%, in 2004. Increases in net patient service revenue primarily are due to increases in outpatient volumes, surgery, and the addition of new procedures, including PET CT, IMRT, Prostate Brachytherapy, and Digital Mammography. Overall activity at the Hospital, as measured by inpatient acute discharges, decreased 1% to 7,167 discharges in 2004 from 7,239 discharges in 2003. Acute patient days increased 2% over prior year from 26,964 in 2003 to 27,437 in 2004. As a result, the average length of stay for all patients (excluding newborns) increased to 3.83 days in 2004 from 3.71 days in 2003.

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Management's Discussion and Analysis (continued)

Table 6 presents the relative percentages of gross charges billed for patient services by payor for fiscal years 2004 and 2003:

TABLE 6

	Year ended September 30	
	2004	2003
Medicare	49%	51%
Managed care	38	36
Medicaid	10	9
Self-pay	3	4
	100%	100%

The following table presents the components of net patient service revenue for fiscal years 2004 and 2003:

TABLE 7

	Year ended September 30		Change	
	2004	2003	Dollar	Percent
	<i>(In Thousands)</i>			
Gross patient service charges	\$ 206,194	\$ 189,379	\$ 16,815	9%
Contractual and other allowances:				
<i>Medicare</i>	70,455	63,644	6,811	11%
Managed care	28,870	25,283	3,587	14%
Medicaid	17,988	13,811	4,177	30%
Other	5,727	4,314	1,413	33%
Total contractual allowances	123,040	107,052	15,988	15%
	83,154	82,327	827	1%
Provision for bad debts	4,506	5,695	(1,189)	(21)%
Net patient service revenue	\$ 78,648	\$ 76,632	\$ 2,016	3%

While gross patient service charges increased \$16,815,000, or 9%, from prior year due to increased volume and rate increases, net patient service revenue, before provision for bad debts, increased \$827,000, or 1%, due to an increase in total contractual allowances as a percentage of gross patient service charges.

Excluded from gross patient service charges are amounts forgone for patient services falling under the Hospital's charity care policy. These amounts are based on established

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Management's Discussion and Analysis (continued)

rates for the services provided. Gross charges of \$884,000 were forgone during the current fiscal year compared to \$739,000 in the prior fiscal year.

The provision for bad debts decreased to \$4,506,000 from the prior-year amount of \$5,695,000. This \$1,189,000, or 21%, decrease is driven primarily by the increased focus to collect charges.

Operating Expenses

Employee-related expenses increased \$743,000, or 3%, to \$30,197,000 in the current fiscal year from \$29,454,000 in the prior fiscal year. The increase is mainly due to wage increases that were effective January 2004. As a percentage of total revenue, these expenses were approximately 38% and 38% for 2004 and 2003, respectively.

Other operating expense increased \$441,000, or 1%, from prior year. As a percentage of total revenue, these expenses were approximately 39% for each of the fiscal years ended September 2004 and 2003.

Depreciation and amortization expense increased \$1,282,000, or 21%, from prior year. The increase is due to additions to capital assets of \$18,681,000 during 2004.

Interest expense decreased to \$278,000, or 73%, from the prior year. The decrease is due to the bonds being fully repaid during 2004.

Nonoperating Income

Nonoperating income is comprised primarily of investment income. Investment income consists of interest earnings on funds designated by the board of commissioners. Other gains realized that are not directly related to the provision of health care services are also classified as nonoperating income. The net unrealized gain on market value adjustments is also included in this amount. Nonoperating income decreased from the prior year due to the sale of investments to retire all outstanding long-term debt.

Contacting the Hospital's Financial Manager

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Hospital's finances and to demonstrate the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Hospital administration.

Report of Independent Auditors

The Board of Commissioners
Hospital Service District No. 3 of the Parish
of Lafourche, State of Louisiana

We have audited the accompanying balance sheets of Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center) (the "Hospital"), as of September 30, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and in accordance with the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital at September 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 1, 2005, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages i through vii is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Ernst & Young LLP

February 1, 2005

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Balance Sheets

	September 30	
	2004	2003
Assets		
Current assets:		
Cash and cash equivalents	\$ 11,274,328	\$ 7,415,731
Investments	648,403	646,407
Patient accounts receivable, less allowances for uncollectible accounts of \$8,996,000 in 2004 and \$12,582,000 in 2003	13,057,336	13,746,195
Assets whose use is limited and required for current liabilities	—	1,425,938
Interest and other receivables	15,011	21,870
Inventories	1,188,450	1,149,717
Prepaid expenses	721,338	729,120
Total current assets	26,904,866	25,134,978
Assets whose use is limited, less amounts required for current liabilities	70,818,622	89,083,835
Unamortized debt issuance costs	—	215,953
Other assets	—	83,085
Property, plant, and equipment:		
Land and land improvements	3,370,155	3,338,077
Buildings and fixed equipment	45,089,596	43,795,319
Equipment	48,128,150	46,658,836
Accumulated depreciation and amortization	(49,621,210)	(46,339,500)
Construction in progress	14,391,254	2,618,410
	61,357,945	50,071,142
	<u>\$ 159,081,433</u>	<u>\$ 164,588,993</u>

	September 30	
	2004	2003
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,756,380	\$ 3,710,053
Employee compensation	3,923,823	3,687,189
Amounts due to contractual third-party payers	2,282,583	3,224,272
Payables related to assets whose use is limited:		
Accrued interest	—	506,313
Amounts due within one year on long-term debt	—	425,000
Total current liabilities	<u>10,962,786</u>	<u>11,552,827</u>
Long-term debt, less amounts due within one year	—	16,233,151
Total liabilities	<u>10,962,786</u>	<u>27,785,978</u>
Net assets:		
Invested in capital assets, net of related debt	61,357,945	33,412,991
Restricted	—	2,569,831
Unrestricted	86,760,702	100,820,193
Total net assets	<u>148,118,647</u>	<u>136,803,015</u>
	<u>\$ 159,081,433</u>	<u>\$ 164,588,993</u>

See accompanying notes.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
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Statements of Revenues, Expenses, and Changes in Net Assets

	Year ended September 30	
	2004	2003
Net patient service revenue	\$ 78,647,869	\$ 76,632,276
Other revenue	1,370,828	1,565,953
Total revenue	80,018,697	78,198,229
Expenses:		
Salaries and wages	25,887,502	24,971,667
Employee benefits and payroll taxes	4,309,983	4,482,913
Professional fees	7,999,188	8,351,395
Supplies and materials	11,956,412	11,412,044
Purchased services	5,878,043	5,254,589
Other	5,131,772	5,505,759
Depreciation and amortization	7,365,828	6,084,109
Interest	277,540	1,036,676
Total expenses	68,806,268	67,099,152
Income from operations	11,212,429	11,099,077
Nonoperating income:		
Realized investment income	1,024,046	1,147,774
Other	(92,760)	1,061
Total nonoperating income	931,286	1,148,835
Revenue in excess of expenses	12,143,715	12,247,912
Bond retirement costs	828,083	—
Revenue in excess of expenses and bond retirement costs	11,315,632	12,247,912
Increase in restricted net assets	—	16,602
Net assets at beginning of year	136,803,015	124,538,501
Net assets at end of year	\$ 148,118,647	\$ 136,803,015

See accompanying notes.

**Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
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Statements of Cash Flows

	Year ended September 30	
	2004	2003
Operating activities		
Revenue collected	\$ 79,765,867	\$ 79,688,354
Cash payments to employees and for employee-related costs	(29,960,851)	(29,312,639)
Cash payments for operating expenses	(29,821,047)	(29,375,912)
Net cash provided by operating activities	19,983,969	20,999,803
Investing activities		
Interest received on investments	1,024,046	1,164,376
Purchases of funds designated under bond resolutions	(14,563,209)	(13,692)
Sales and maturities of funds designated under bond resolutions	17,133,040	1,423,625
Purchases of funds designated by board for plant repair and expansion	(878,680)	(14,310,177)
Sales and maturities of funds designated by board for plant repair and expansion	18,000,000	—
Purchases of investments	(1,996)	(41,576)
Sales and maturities of investments	—	5,000,000
Net cash provided by (used in) investing activities	20,713,201	(6,777,444)
Capital and related financing activities		
Purchases of property, equipment, and other assets	(18,681,459)	(16,649,518)
Proceeds on sale of property, equipment, and other assets	—	37,597
Principal payments on debt incurred for capital purposes	(16,950,001)	(375,951)
Interest payments on debt	(783,853)	(1,005,831)
Bond retirement costs paid	(330,500)	—
Net cash used in capital and related financing activities	(36,745,813)	(17,993,703)
Noncapital financing activity		
Other nonoperating income received (expenses paid), net	(92,760)	1,061
Net cash provided by (used in) noncapital financing activity	(92,760)	1,061
Net increase (decrease) in cash and cash equivalents	3,858,597	(3,770,283)
Cash and cash equivalents at beginning of year	7,415,731	11,186,014
Cash and cash equivalents at end of year	\$ 11,274,328	\$ 7,415,731
Reconciliation of income from operations to net cash provided by operating activities		
Income from operations	\$ 11,212,429	\$ 11,099,077
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	7,272,523	5,567,810
Amortization	93,305	540,348
Interest expense on debt	277,540	1,012,627
Provision for doubtful accounts	4,506,452	5,694,160
Loss on sale of equipment	122,133	4,453
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(3,817,593)	(5,175,604)
Decrease in other receivables	6,859	556,774
Increase in inventories and prepaid expenses	(30,951)	(362,774)
(Increase) decrease in other assets	—	1,214,753
Increase (decrease) in accounts payable, accrued expenses, and employee compensation	1,282,961	(123,390)
Increase (decrease) in amounts due to contractual third-party payers	(941,689)	971,569
Net cash provided by operating activities	\$ 19,983,969	\$ 20,999,803

See accompanying notes.

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Notes to Basic Financial Statements

September 30, 2004

1. Organization and Significant Accounting Policies

Organization

The accompanying financial statements include the accounts and transactions of Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center) (the "Hospital"). Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana, is a nonprofit corporation organized by Lafourche Parish. The Lafourche Parish Council, which is the governing authority of Lafourche Parish, Louisiana, appoints members to the Hospital's board of commissioners. As a political subdivision, the Hospital is exempt from federal income taxes under Section 115 of the Internal Revenue Code. This exemption also extends to state income taxes.

Basis of Accounting

The Hospital reports in accordance with accounting principles generally accepted in the United States as specified by the American Institute of Certified Public Accountants' *Audits of Providers of Health Care Services* and, as a governmental entity, also reports in accordance with accounting principles promulgated by the Governmental Accounting Standards Board ("GASB").

The Hospital uses the accrual basis of accounting for proprietary funds. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting*, the Hospital has elected not to apply Financial Accounting Standards Board ("FASB") pronouncements issued after November 30, 1989.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
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Notes to Basic Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Operating Revenue and Nonoperating Income

The Hospital's primary purpose is to provide diversified health care services to individuals, physicians, and businesses in Lafourche Parish and the surrounding communities. As such, activities related to the ongoing operations of the Hospital are classified as operating revenue. Operating revenue includes that generated from direct patient care, related support services, gains or losses from disposition of operating properties, rental income, and sundry revenues related to the operation of the Hospital.

Income, gains, and losses from investments not generated from operating funds and those not directly related to the ongoing operations of the Hospital or that occur infrequently, and gifts, grants, and bequests not restricted by donors for specific purposes, are reported as nonoperating income.

Net Patient Service Revenue and Related Receivables

The Hospital provides medical services to government program beneficiaries and has agreements with other third-party payers that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue and related receivables are reported at the estimated net realizable amounts billed to patients, third-party payers, and others for services rendered. The percentage of total net patient service revenue derived from services furnished to Medicare and Medicaid program beneficiaries was approximately 40% in 2004 and 42% in 2003.

Retroactive settlements are provided for in some of the governmental payment programs outlined above, based on annual cost reports. Such settlements are estimated and recorded as amounts due to or from third-party payers in the financial statements. The differences between these estimates and final determination of amounts to be received or paid are based on audits by fiscal intermediaries and are reported as adjustments to net patient service revenue when such determinations are made. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. These adjustments resulted in increases to net patient service revenue of \$1,168,000 in 2004 and \$566,000 in 2003. Estimated settlements through September 30, 2001, for the Medicare program and through September 30, 2000, for the Medicaid

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Notes to Basic Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

program have been reviewed by program representatives, and adjustments have been recorded to reflect any revisions to the recorded estimates required. The effect of any adjustments that may be made to cost reports still subject to review at September 30, 2004, will be reported in the Hospital's results of operations as such determinations are made.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care provided was \$884,000 in 2004 and \$739,000 in 2003.

Cash Equivalents

Cash and cash equivalents include all cash and highly liquid investments that are readily convertible to cash and so near maturity that they present insignificant risk of changes in value because of changes in interest rates, excluding amounts whose use is limited by board designation or under trust agreements.

Investments

All investments are stated at fair value based on quoted market price. Changes in the fair value of investments are included in investment income.

Inventories

Inventories are valued at the latest invoice price, which approximates the lower of cost (first-in, first-out method) or market.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
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Notes to Basic Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

Property, Plant, and Equipment

The Hospital records all property, plant, and equipment acquisitions at cost except for assets donated to the Hospital. Donated assets are recorded at fair value at the date of donation. The Hospital provides for depreciation using the straight-line method over the estimated useful lives of the assets.

Net Assets

The Hospital's net assets are classified into three components and are defined as follows:

- Invested in capital assets, net of related debt—This component reports capital assets, including restricted capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted—This component reports those net assets with externally imposed constraints placed on their use by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. Income earned on net assets reported in this component is reported as an increase in restricted net assets in the accompanying statements of revenue, expenses, and changes in net assets.
- Unrestricted—This component reports net assets that do not meet the definition of either of the other two components.

2. Long-Term Debt

During 2004, the Hospital repaid the Hospital Revenue Bonds, Series 1993. The redemption of the bonds prior to maturity was subject to a premium of up to 2%. All unamortized debt issuance costs and original issue discounts were expensed at the time of the redemption.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

2. Long-Term Debt (continued)

The details and balances of long-term debt as of September 30, 2003 are presented below:

	<u>2003</u>
Hospital Revenue Bonds, Series 1993	\$ 16,950,000
Less: Unamortized original issue discount	291,849
Amounts due within one year	425,000
	<u>\$ 16,233,151</u>

3. Cash, Cash Equivalents, and Investments

At September 30, 2004 and 2003, the bank balances of the Hospital's deposits, which are included in cash and cash equivalents, investments, and assets whose use is limited in the balance sheet, were entirely insured or collateralized with securities held by the pledging bank in the Hospital's name. In addition, the Hospital had investments in direct obligations of the U.S. Government and government agencies of \$10,198,965 and \$2,693,742 at September 30, 2004 and 2003, respectively, and in money market accounts whose underlying investments consist solely of U.S. Government securities of \$273,403 and \$271,407 at September 30, 2004 and 2003, respectively. The U.S. Government obligations are uninsured and unregistered, with securities held by the trustee in the Hospital's name. The money market funds are uninsured and unregistered, with securities held by the trustee but not in the Hospital's name.

The fair values for U.S. Government and government agency obligations are based on the market prices listed by independent pricing services. The fair values for money market accounts and certificates of deposit are based on cost, which equals fair value.

Statutes authorize the Hospital to invest in direct obligations of the U.S. Government or its agencies, certificates of deposit of state banks and national banks having their principal office in the State of Louisiana, and any other federally insured investments, guaranteed investment contracts issued by a financial institution having one of the two highest rating categories published by Standard & Poor's or Moody's, and mutual or trust funds registered with the Securities and Exchange Commission (provided the underlying investments of these funds meet certain restrictions).

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

4. Assets Whose Use Is Limited

Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets. The total composition of assets whose use is limited at September 30, 2004 and 2003 is set forth below:

	<u>2004</u>	<u>2003</u>
Funds designated by board for plant repair and expansion	\$ 70,818,622	\$ 87,939,942
Funds designated under bond resolutions for Hospital Revenue Bonds, Series 1993:		
Debt Reserve Fund	—	1,465,895
Debt Service Fund	—	1,103,936
	<u>\$ 70,818,622</u>	<u>\$ 90,509,773</u>

5. Retirement Plan

The Hospital sponsors a deferred compensation plan under Section 457(b) of the Internal Revenue Code (the "Plan"). The Plan covers all employees age 21 or older with one year of service in which at least 1,000 hours were worked. The Plan provides that the Hospital, at its option, may make contributions to the Plan based on a discretionary percentage of eligible employees' base compensation, as defined, as well as matching contributions. The Hospital's discretionary contribution percentage was 4% for the years ended September 30, 2004 and 2003. The Plan permits tax deferral by employees of amounts, combined with the Hospital's contribution, up to a maximum of 25% of their base compensation, subject to certain limits. Employer contributions vest at 20% per year until they reach 100% at the end of year five. Employee contributions are immediately vested.

Retirement expense recorded by the Hospital for the years ended September 30, 2004 and 2003 totaled approximately \$609,000 and \$598,000, respectively, or approximately 4% of covered payroll in each year.

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

6. Contingencies

The Hospital participates in the State of Louisiana Patient Compensation Fund (the "Fund") for medical malpractice claims. As a participant, the Hospital has a statutory *limitation of liability* which provides that no award can be rendered against it in excess of \$500,000, plus interest and costs. The Fund provides coverage on a claims-made basis for claims over \$100,000 and up to \$500,000. The Hospital is also insured on a claims-made basis through a commercial insurance carrier for malpractice losses up to \$6,000,000 per occurrence, with a total limit of \$8,000,000, and with a self-insurance retention of \$100,000 per occurrence up to a maximum of \$300,000 in the aggregate per year.

The Hospital has been named as defendant in lawsuits alleging medical malpractice. Management of the Hospital, using information provided by its commercial insurance carrier, has accrued in the financial statements its best estimate of probable contingent losses on these claims and on estimated claims incurred but not reported.

The Hospital is self-insured for workers' compensation up to \$50,000 per claim and for employee health insurance up to \$100,000 per claim. A liability is recorded when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. Liabilities for claims incurred are reevaluated periodically to take into consideration recently settled claims, frequency of claims, and other economic and social factors. The Hospital purchased commercial insurance that provides coverages for workers' compensation and employee health claims in excess of the self-insured limits.

Changes in the Hospital's aggregate claims liability for medical malpractice, workers' compensation, and employee health insurance in fiscal years 2004 and 2003 were as follows:

Year Ended September 30	Beginning of Fiscal Year Liability	Current-Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
2004	\$ 1,854,000	\$ 2,554,000	\$ 2,594,000	\$1,814,000
2003	\$ 1,802,000	\$ 2,126,000	\$ 2,074,000	\$1,854,000

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

7. Postemployment Benefits

The Hospital provides health care benefits to retired Hospital employees and their families. Employees with at least ten years of service and who are age 55 or older at retirement are eligible to participate. Effective January 1, 1996, plan participants are required to contribute 100% of the plan's monthly premium. The Hospital records the excess benefits over the contributions as expense as the benefits are used. For the fiscal year ended September 30, 2004, 20 retired employees participated in the plan.

8. Property, Plant, and Equipment

Property, plant, and equipment at September 30, 2004 and 2003 consisted of the following:

	Beginning Balance	Additions	Reclassification/ Retirements	Ending Balance
Land and land improvements	\$ 3,338,077	\$ 32,078	\$ -	\$ 3,370,155
Building and fixed equipment	43,795,319	1,476,913	(182,636)	45,089,596
Equipment	46,658,836	5,399,624	(3,930,310)	48,128,150
Construction in progress	2,618,410	13,170,413	(1,397,569)	14,391,254
	96,410,642	20,079,028	(5,510,515)	110,979,155
Less accumulated depreciation and amortization	(46,339,500)	(7,272,523)	3,990,813	(49,621,210)
Property, plant, and equipment, net	\$ 50,071,142	\$ 12,806,505	\$ (1,519,702)	\$ 61,357,945

9. Operating Leases

The Hospital leases various equipment and facilities under operating leases expiring at various dates through September 2008. The following is a schedule by year of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year.

2005	\$ 184,594
2006	169,584
2007	70,685
2008	62,057
2009	62,057
	<u>\$ 548,977</u>

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

9. Operating Leases (continued)

Total rental expense was \$1,179,000 in 2004 and \$1,254,000 in 2003.

The Hospital leases office space in a medical office building and clinical facilities, generally to members of its medical staff, under operating leases with terms ranging up to five years. The future minimum lease payments to be received from these leases follow:

2005	\$ 694,000
2006	643,000
2007	83,000
	<u>\$ 1,420,000</u>

The cost of assets held for lease totaled \$5,090,000 at September 30, 2004. Related accumulated amortization was approximately \$419,000 at September 30, 2004.

10. Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross receivables from third-party payers at September 30, 2004 and 2003, was as follows:

	<u>2004</u>	<u>2003</u>
Self-pay	38%	38%
Medicare	30	25
Medicaid	6	18
Managed care	24	17
Other	2	2
	<u>100%</u>	<u>100%</u>

Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana
(d/b/a Thibodaux Regional Medical Center)

Notes to Basic Financial Statements (continued)

11. Governmental Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers in recent years. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of the
Financial Statements Performed in Accordance With
*Government Auditing Standards***

The Board of Commissioners
Hospital Service District No. 3 of the
Parish of Lafourche, State of Louisiana

We have audited the financial statements of Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center) (the "Hospital") as of and for the year ended September 30, 2004, and have issued our report thereon dated February 1, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to management of the Hospital in a separate letter dated February 1, 2005.

This report is intended solely for the information and use of the board of commissioners, management, and the Office of Legislative Auditor, State of Louisiana, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

February 1, 2005

The Finance Committee of
the Board of Commissioners
Hospital Service District No. 3 of the Parish
of Lafourche, State of Louisiana

In planning and performing our audit of the financial statements of Hospital Service District No. 3 of the Parish of Lafourche, State of Louisiana (d/b/a Thibodaux Regional Medical Center) (the "Medical Center"), for the year ended September 30, 2004, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. The following observations, which resulted from our consideration of internal control, are submitted for your consideration relative to significant estimates and management judgments.

The Medical Center's financial statements include amounts and balances that are to a significant degree based on management's judgments and estimates. Several of the processes management uses to make these judgments and estimates were modified during the current year in response to significant changes in the health care industry, the local operating environment, and the Medical Center's routine processes. We believe the changes made by management were appropriate and responsive to the noted changes. We have the following recommendations to enhance these processes.

Interim Financial Reporting

The Medical Center's interim financial statements are used by management and the board of commissioners to make investment and operating decisions. Accordingly, it is important that the interim financial statements reflect a fair presentation of interim results and incorporate all necessary adjustments. Significant adjustments were recorded to the year-end financial statements as a result of the audit process. We believe management could improve the interim accounting processes. Specifically, three of the more significant areas that should be focused on include the allowance for contractual adjustments, the allowance for uncollectible accounts, and the third-party accounts.

The allowance for contractual adjustments estimate is material and highly sensitive to changes in historical collection rates. We suggest management establish a process to assess the adequacy of prior-period contractual allowance estimates through a retrospective analysis similar to the hindsight review of the allowance for uncollectible accounts. We also suggest that management's periodic assessment of the allowance for uncollectible accounts estimate be expanded to include a monthly table of historical

collection and write-off amounts by financial class to develop data. Over time, trends in this data can provide management with additional indicators of the net realizable value of accounts receivable. The settlement reserves are the final allowance that uses a significant amount of judgment in estimating cost-based reimbursements with governmental payers. Laws and regulations governing these reimbursements are complex and subject to interpretation. Management recognizes reserves for specific items where potential exposure exists due to differing interpretations of these governmental regulations. We recommend that management expand their process and add an analysis of the development of prior years' specific reserve items.

* * * * *

This letter is intended solely for the information and use of the finance committee, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions at your convenience.

Ernst & Young LLP

February 1, 2005



**THIBODAUX REGIONAL
MEDICAL CENTER**
*Hospital Service District #3
Parish of Lafourche*

**Response to Management Letter
FY 09-30-04 Audit**

Interim Financial Reporting

The Hospital maintains monthly logs of expected payments from third parties on all billed claims. An estimate is made on unbilled claims based on these expected payments. We plan to continue to review the logs of paid claims on a monthly basis in order to verify that estimated payments computed are accurate.

We did perform a hindsight analysis on allowance for doubtful accounts and made revisions to our write-off percentages during fiscal year 9-03-04. We will begin to perform an analysis for contractual allowance estimates by reviewing actual payments and adjustments made on prior year outstanding claims. We will then compare these to estimates to determine if revisions in methodology are necessary.

Reserve estimates will be adjusted as prior year cost reports are settled. Specific items which have been adjusted based on Medicare/Medicaid review will be taken into account when setting up reserve items.

Steve Gaubert

Steve Gaubert
Chief Financial Officer
Thibodaux Regional Medical Center